

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City of Scottsdale's (the City) Comprehensive Annual Financial Report presents a narrative overview and comparative analysis of the financial activities of the City for the fiscal years ended June 30, 2003 and 2002. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal.

FINANCIAL HIGHLIGHTS

The assets of the City exceeded its liabilities at the close of the fiscal years 2003 and 2002 by \$2.6 billion and \$2.5 billion (net assets), respectively. Of these amounts, \$346.2 million and \$328.4 million (unrestricted net assets), respectively, may be used to meet the government's ongoing obligations to citizens and creditors.

The City's total net assets increased by \$96.0 million and \$127.3 million during fiscal years 2003 and 2002, respectively.

As of June 30, 2003 and 2002, the City's governmental funds reported combined ending fund balances of \$270.9 million and \$283.6 million, respectively. The decrease is primarily due to the capital spending of bond proceeds received in fiscal year 2002. Approximately 94.2 percent of the fund balance at June 30, 2003, \$255.2 million, is unreserved fund balance available for spending at the government's discretion, compared to \$268.7 million at June 30, 2002. However, in fiscal year 2003 management has designated \$58.4 million of the unreserved fund balance for various uses.

At the close of the current fiscal year, unreserved fund balance for the General Fund was \$71.2 million or 42.0 percent of total General Fund expenditures of \$169.7 million. At the close of fiscal year 2002, unreserved fund balance for the General Fund was \$74.4 million or 45.1 percent of total General Fund expenditures of \$164.0 million.

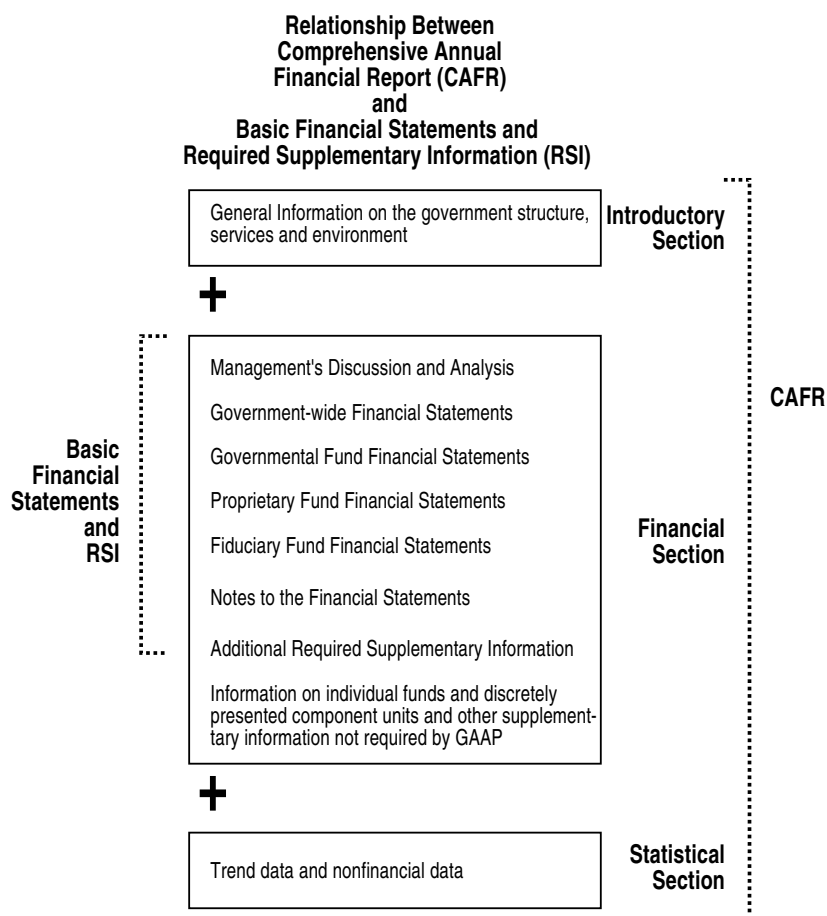
During fiscal year 2003, the City's total bonded debt decreased by approximately \$25.5 million, in contrast to the increase of approximately \$52.5 million in fiscal year 2002. Although the City completed several refunding transactions, the key contributor to the decrease was normal debt service payments.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components:

- (1) **Government-wide** financial statements,
- (2) **Fund** financial statements, and
- (3) **Notes** to the financial statements.

This report also contains other **supplementary information** in addition to the basic financial statements themselves.



Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The **statement of net assets** presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether or not the financial position of the City is improving or deteriorating.

The **statement of activities** presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, police, financial services, transportation, community services, information systems, planning and development, fire, municipal services, and citizen and neighborhood resources. The business-type activities of the City include water, sewer, solid waste, and airport operations.

The government-wide financial statements are for the City itself. However, included within the governmental activities of the government-wide financial statements are the operations of the City of Scottsdale Municipal Property Corporation (MPC), the Scottsdale Preserve Authority (SPA), and Scottsdale Mountain, McDowell Mountain Ranch, DC Ranch, and Via Linda Road Community Facilities Districts. Although legally separate from the City, these component units are blended with the primary government because of their governance or financial relationships to the City.

Separate financial statements of the MPC, SPA and Scottsdale Mountain, McDowell Mountain Ranch, DC Ranch, and Via Linda Road Community Facilities Districts may be obtained at the City's Financial Services Department, Accounting Division, 7447 East Indian School Road, Suite 210, Scottsdale, Arizona 85251.

The government-wide financial statements can be found on pages 32 and 33 of this report.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into the following three categories: **Governmental Funds**, **Proprietary Funds**, and **Fiduciary Funds**.

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in determining what financial resources are available in the near future to finance the City's programs.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains several individual governmental funds organized according to their type (special revenue, debt service, and capital projects). Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, General Obligation Bond Debt Service Fund, and General Capital Improvement Plan Construction Capital Projects Fund, which are considered to be major funds. Data from the remaining governmental funds are combined into a single, aggregated presentation.

Individual fund data for each of the non-major governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual appropriated budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget.

Proprietary Funds

Proprietary Funds are generally used to account for services for which the City charges customers—either outside customers, or internal units or departments of the City. Proprietary Funds provide the same type of information as shown in the government-wide financial statements, only in more detail. The City maintains the following two types of Proprietary Funds:

Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses Enterprise Funds to account for the operations of the Water, Sewer and Solid Waste operations of the City as well as the Airport. All Enterprise Funds are considered to be major funds of the City.

Internal Service Funds are used to report activities that provide supplies and services for certain City programs and activities. The City uses Internal Service Funds to account for its fleet of vehicles and self-insurance. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. The Internal Service Funds are combined into a single, aggregated presentation in the propriety fund financial statements. Individual fund data for the Internal Service Funds is provided in the form of combining statements elsewhere in this report.

Fiduciary Funds

Fiduciary Funds are used to account for resources held for the benefit of parties outside the City. The City has two private-purpose trust funds and two agency funds, which are reported under the Fiduciary Funds. Fiduciary Funds are not reflected in the government-wide financial

statement because the resources of those funds are not available to support the City's own programs. The accounting used for Fiduciary Funds is much like that used for Proprietary Funds.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees.

Combining Statements

The combining statements referred to earlier in connection with non-major governmental funds, Internal Service Funds, and Fiduciary Funds are presented immediately following the required supplementary information on pensions.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Analysis of Net Assets

As noted earlier, net assets may serve as a useful indicator of a government's financial position. For the City, assets exceeded liabilities by \$2.6 billion and \$2.5 billion at the close of the fiscal years 2003 and 2002, respectively.

The largest portion of the City's net assets reflects its investment of \$2.15 billion (81.7 percent) and \$2.06 billion (81.1 percent) in capital assets (e.g. land, buildings, and equipment), less any related outstanding debt used to acquire those assets, for the fiscal years 2003 and 2002, respectively. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be liquidated for these liabilities.

Net Assets

June 30, 2003 and 2002 (in thousands of dollars)

	Governmental		Business-type		Total	
	Activities		Activities			
	2003	2002	2003	2002	2003	2002
Assets						
Current and other assets	\$ 384,223	\$ 387,530	\$ 227,423	\$ 210,073	\$ 611,646	\$ 597,603
Capital Assets	2,023,879	1,977,725	754,640	741,373	2,778,519	2,719,098
Total Assets	2,408,102	2,365,255	982,063	951,446	3,390,165	3,316,701
Liabilities						
Long-term liabilities outstanding	562,122	552,788	96,855	96,300	658,977	649,088
Other liabilities	75,161	96,781	23,210	34,017	98,371	130,798
Total Liabilities	637,283	649,569	120,065	130,317	757,348	779,886
Net Assets						
Invested in capital assets, net of related debt	1,492,879	1,429,495	659,130	629,106	2,152,009	2,058,601
Restricted	117,801	133,460	16,721	16,399	134,522	149,859
Unrestricted	160,139	152,731	186,147	175,624	346,286	328,355
Total Net Assets	1,770,819	1,715,686	861,998	821,129	2,632,817	2,536,815
Total Liabilities and Net Assets	\$ 2,408,102	\$ 2,365,255	\$ 982,063	\$ 951,446	\$ 3,390,165	\$ 3,316,701

An additional portion of the City's net assets, \$134.5 million (5.1 percent) for fiscal year 2003 and \$149.8 million (5.9 percent) for fiscal year 2002 represent resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets for fiscal years 2003 and 2002, \$346.3 million (13.2 percent) and \$328.4 million (12.9 percent), respectively, may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of both the current and previous fiscal years, the City was able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for the business-type activities.

Analysis of Changes in Net Assets

The City's total net assets increased by \$96.0 million and \$127.2 million during the fiscal years 2003 and 2002, respectively. These increases are explained in the government and business-type activities discussion herein, and are primarily a result of contributions from developers of infrastructure assets.

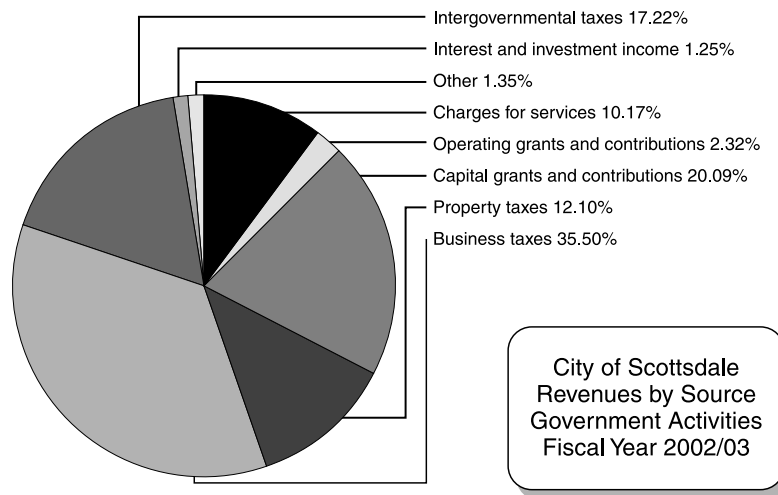
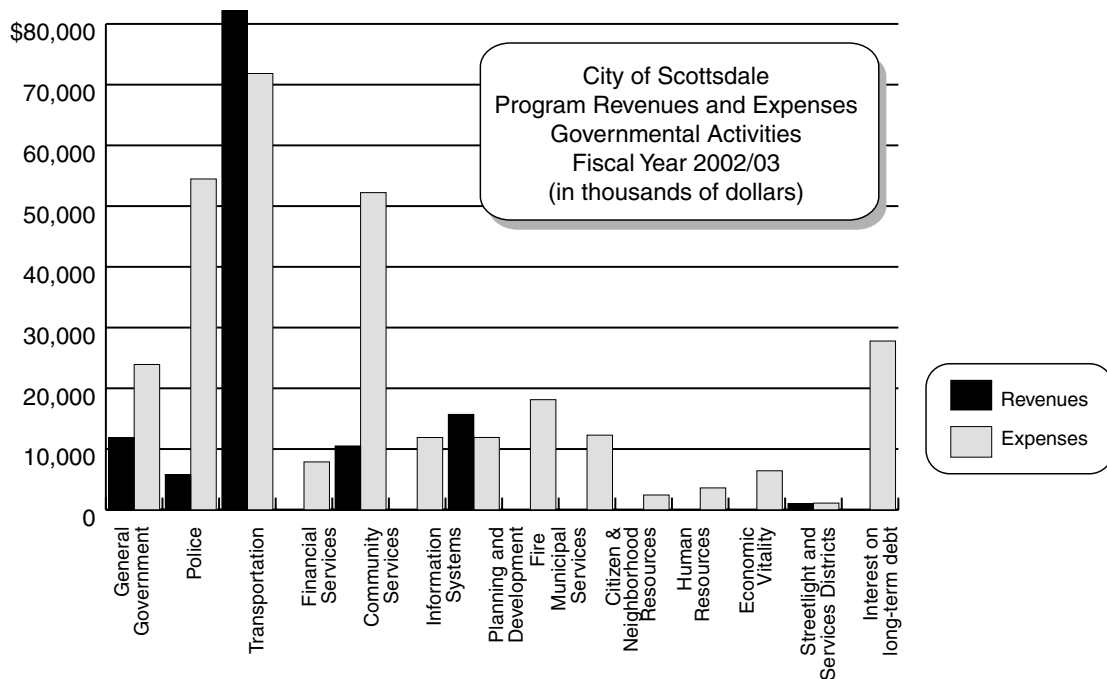
Changes in Net Assets

For the Years Ended June 30, 2003 and 2002 (in thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Revenues						
Program Revenues:						
Charges for Services	\$ 35,501	\$ 36,954	\$ 110,616	\$ 109,566	\$ 146,117	\$ 146,520
Operating Grants and Contributions	21,219	9,626	-	-	21,219	9,626
Capital Grants and Contributions	70,369	77,412	28,487	38,733	98,856	116,145
General Revenues:						
Property Taxes	42,218	39,485	-	-	42,218	39,485
Business Taxes	124,935	127,620	-	-	124,935	127,620
Intergovernmental Taxes	46,971	57,492	-	-	46,971	57,492
Interest and Investment Income	4,108	11,485	1,493	5,820	5,601	17,305
Other	4,718	5,213	1,672	-	6,390	5,213
Total Revenues	350,039	365,287	142,268	154,119	492,307	519,406
Expenses						
General Government	\$ 23,926	\$ 26,982	\$ -	\$ -	\$ 23,926	\$ 26,982
Police	54,469	52,719	-	-	54,469	52,719
Financial Services	7,883	7,464	-	-	7,883	7,464
Transportation	71,837	72,159	-	-	71,837	72,159
Community Services	52,222	53,325	-	-	52,222	53,325
Information Systems	11,901	10,821	-	-	11,901	10,821
Fire	18,127	16,494	-	-	18,127	16,494
Municipal Services	12,290	11,482	-	-	12,290	11,482
Citizen and Neighborhood Resources	2,433	2,484	-	-	2,433	2,484
Human Resources	3,601	-	-	-	3,601	-
Economic Vitality	6,421	-	-	-	6,421	-
Planning and Development	11,908	18,269	-	-	11,908	18,269
Streetlight and Services Districts	1,099	1,044	-	-	1,099	1,044
Interest on Long-term Debt	27,786	28,063	-	-	27,786	28,063
Water Utility	-	-	50,406	51,125	50,406	51,125
Sewer Utility	-	-	22,862	24,007	22,862	24,007
Airport	-	-	2,476	2,648	2,476	2,648
Solid Waste	-	-	13,783	14,071	13,783	14,071
Total Expenses	305,903	301,306	89,527	91,851	395,430	393,157
Increase in Net Assets Before Special Items and Transfers	44,136	63,981	52,741	62,268	96,877	126,249
Gain/(Loss) on Sale of Capital Asset	42	234	(917)	874	(875)	1,108
Transfers	10,955	6,223	(10,955)	(6,289)	-	(66)
Increase in Net Assets	55,133	70,438	40,869	56,853	96,002	127,291
Net Assets at Beginning of Year	1,715,686	1,645,248	821,129	764,276	2,536,815	2,409,524
Net Assets at End of Year	\$ 1,770,819	\$ 1,715,686	\$ 861,998	\$ 821,129	\$ 2,632,817	\$ 2,536,815

Governmental activities. Governmental activities increased the City's net assets by \$55.1 million in fiscal year 2003 and \$70.4 million in fiscal year 2002, thereby accounting for 57.4 percent and 55.3 percent, respectively, of the total growth in the net assets of the City. Key factors of this increase are as follows:

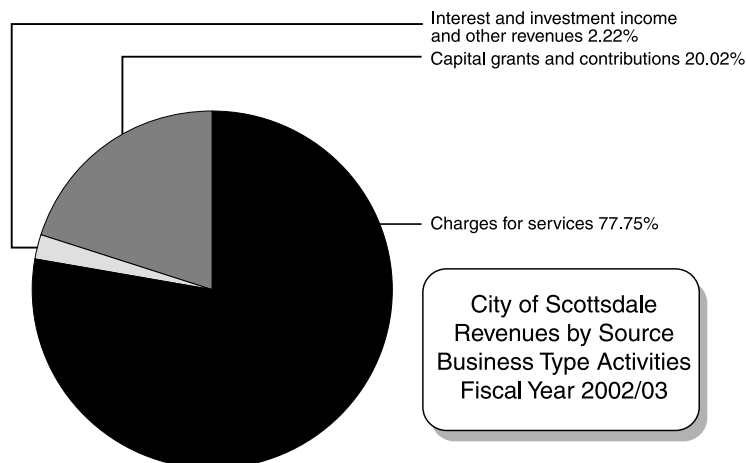
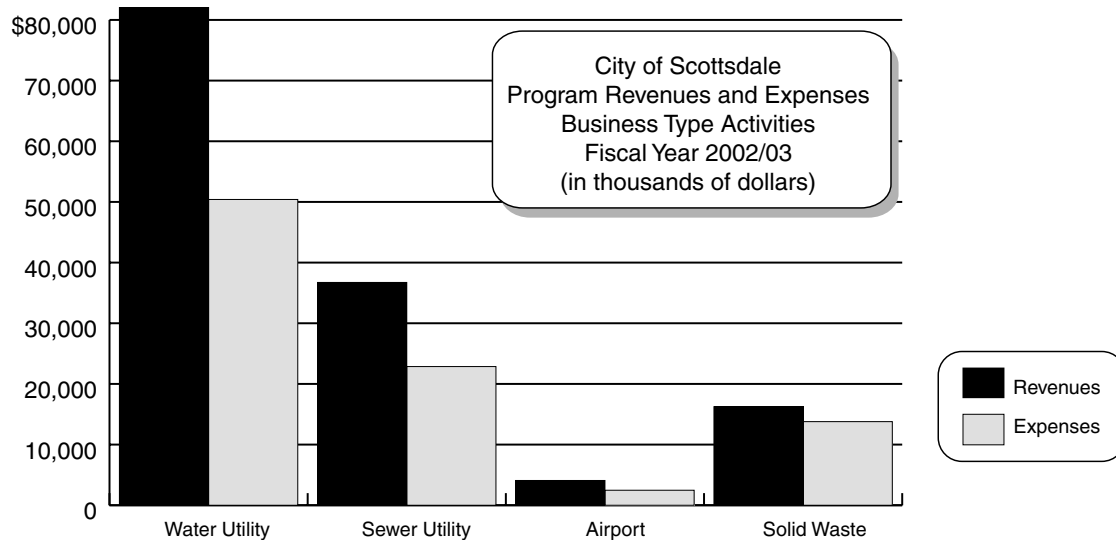
- For the second consecutive year, City sales tax posted negative year-over-year growth in the 2003 fiscal year. However, property taxes were up 6.9 percent and 4.6 percent, respectively, over the previous year. In preparation for the revenue decrease, the City placed spending limitations and restrictions on all departments to help ensure that total net assets did not decline.



As shown in the "Program Revenues and Expenses for Governmental Activities" chart and the "Revenues by Source for Governmental Activities" chart, transportation is the largest function in expense (23.5 percent), followed by police (17.8 percent), and community services (17.1 percent). General revenues such as property, business, and privilege taxes are not shown by program, but are effectively used to support program activities citywide. For governmental activities overall, without regard to program, business taxes are the largest single source of funds (35.7 percent), followed by capital grants and contributions (20.1 percent), and intergovernmental taxes (13.4 percent).

Business-type activities. Business-type activities increased the City's net assets in fiscal years 2003 and 2002 by \$40.9 million and \$56.8 million, respectively, accounting for 42.6 percent and 44.7 percent, respectively, of the total growth in the City's net assets. Key factors of this increase are as follows:

- The Water and Sewer Utility Fund had capital contributions from developers and grantors resulting in \$26.8 million and \$35.8 million in revenue for fiscal years 2003 and 2002, respectively. The majority of this amount is from infrastructure donated from developers and development fees received as development continues throughout the City.



- The Airport Fund had capital contributions from grantors resulting in \$1.6 million and \$3.0 million in revenue for fiscal years 2003 and 2002, respectively. The majority of this amount is airport improvements financed by state and federal grants.
- The Solid Waste fund had increase in net assets in 2003 and 2002 of \$1.4 million and \$1.3 million, respectively. Operating expenses for the same periods stayed relatively constant at \$13.7 million and \$13.9 million, respectively. However, revenues increased from \$15.8 million to \$16.3 million from the fiscal year 2002 to 2003, a 3.2 percent increase. Although rates for solid waste services were unchanged from fiscal year 2002 and 2003, the number of homes and business continues to grow as the population increases.

As shown in "Program Revenues and Expenses for Business Type Activities" and the "Revenues by Source for Business Type Activities" charts, the largest of Scottsdale's business-type activities, Water and Sewer utilities, each had expenses in excess of \$50.4 million and \$22.9 million, respectively, in fiscal year 2003, followed by Solid Waste with operating expenses of \$13.7 million. For the fiscal year, revenues exceeded expenses in all four areas of business activity. Fees provided the largest share of revenues (77.8 percent) followed by capital grants and contributions (20.0 percent), which are largely developer contributions and development fees, for all of the business-type activities.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Types of Governmental funds reported by the City include the General Fund, Special

Revenue Funds, Debt Service Funds, and Capital Project Funds.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$270.9 million, a decrease of \$12.7 million in comparison to fiscal year 2002. The combined ending fund balances for fiscal year 2002 were \$283.6 million. The decrease in the current year's fund balance is primarily due to the capital spending of bond proceeds received in fiscal year 2002. Approximately \$255.2 million of the total for fiscal year 2003 and \$268.7 million of the total for fiscal year 2002 constitutes unreserved fund balance, which is available for spending at the City's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed, (1) to pay debt service (\$13.7 million and \$12.8 million for fiscal years 2003 and 2002, respectively); (2) for the repayment of a long-term loan from another fund (\$1.2 million and \$1.1 million for fiscal years 2003 and 2002, respectively) or; (3) to pay for the ongoing cost of the streetlight and services districts (\$801,000 and \$882,000 for fiscal years 2003 and 2002, respectively).

Revenues for governmental functions overall totaled approximately \$285.1 million and \$289.9 million in the fiscal years ended June 30, 2003 and 2002, respectively, which represents a decrease of 1.7 percent (\$4.8 million) and 2.4 percent (\$7.2 million), respectively, from the previous years. In fiscal year 2003 expenditures for governmental functions, totaled \$327.0 million, an increase by 3.4 percent (\$10.7 million) over the fiscal year 2002 total of \$316.4 million. In the fiscal years ended June 30, 2003 and 2002 expenditures for governmental functions exceeded revenues by approximately \$41.9 million (14.7 percent) and \$26 million (9.1 percent), respectively. Increases in the deficit from 2002 to 2003 were caused by decreased interest earnings, federal grants and miscellaneous revenue as well as an increase in police, fire and debt service principal expenditures. A portion of this year's deficit was offset by transfers in from other funds.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, the unreserved fund balance of the General Fund was \$71.2 million, while total fund balance was \$73.2 million. The unreserved and total balances for the General Fund at the end of fiscal year 2002 were \$74.4 million and \$76.4 million,

respectively. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 42.0 percent of the total General Fund expenditures of \$169.7 million in fiscal year 2003 and 45.4 percent of the total General Fund expenditures of \$163.9 million in fiscal year 2002. The total fund balance represents 43.1 percent and 46.6 percent of those same amounts for fiscal years 2003 and 2002, respectively. In fiscal year 2003 management has designated \$58.4 million of the General Fund unreserved fund balance for various uses.

For the second consecutive year the fund balance in the City's General Fund decreased. The decrease in fiscal year 2003 by \$3.1 million is mainly due to the funding of the pay-as-you-go Capital Improvement Plan and decreased revenues due to the current economy and was offset by spending restrictions placed on all departments during the year. Overall, the General Fund's performance resulted in revenues over expenditures in the fiscal year ended June 30, 2003, of \$27.3 million, an increase of 85.7 percent over the comparable figure from the prior year of \$14.7 million.

The General Obligation Bond Debt Service fund is used to account for the accumulation of resources for, and the payment of, general obligation long-term debt principal, interest and related costs. At the end of the current fiscal year, the fund balance of the General Obligation Bond Debt Service Fund was \$9.0 million relatively unchanged from the previous year. The fund balance at the end of fiscal year 2002 was \$8.4 million. During the fiscal year, the City issued \$72,000,000 of General Obligation Refunding Bonds, Series 2002, (advance refunding) dated September 26, 2002, with an average interest rate of 4.5%, to refund \$71,510,000 of Series 1992, 1993, 1994, 1995, 1997, 1998, 1999, 1999A and 2001 General Obligation and Preservation Bonds with an average interest rate of 4.92%. The City will reduce its total debt service payments over the next 22 years by approximately \$3,218,584 and obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$611,585.

The General CIP Construction Capital Project fund accounts for the resources used to acquire,

construct and improve major capital facilities, other than those financed by proprietary funds. At the end of the current fiscal year, the fund balance of the General CIP Construction Capital Project Fund was \$81.2 million. The fund balance at the end of fiscal year 2002 was \$72.5 million. The increase in fund balance is primarily due to amounts transferred from the General Fund to fund the pay-as-you-go Capital Improvement Plan. The increase in funding was offset by increased spending for capital projects. Capital Improvement expenditures in 2003 and 2002 were \$32.3 million and \$23.1 million, respectively, an increase of 39.6 percent.

Proprietary Funds

The City's Proprietary Funds provide the same type of information found in the government-wide financial statements, but in more detail.

At the end of the fiscal years 2003 and 2002, the unrestricted net assets for the Water and Sewer Utility were \$181.5 million and \$171.8 million, respectively; Scottsdale Airport were \$100,000 and \$459,000, respectively; and the Solid Waste Utility Fund \$4.5 million and \$3.3 million, respectively. The Internal Service Funds, which are used to account for certain governmental activities also had unrestricted net assets of \$16.6 million and \$19.8 million, respectively.

The total growth in net assets for the Enterprise Funds was \$40.9 million and \$56.8 million for fiscal years 2003 and 2002, respectively. Factors concerning the finances of these funds have been addressed previously in the discussion of the City's business-type activities. In particular, the Scottsdale Water and Sewer net assets increased by \$38.4 million due to capital contributions of \$26.8 million and increased water and sewer fees of \$3.3 million.

Fiduciary Funds

The City maintains Fiduciary Funds for the assets of the Family Self-Sufficiency Agency Fund, the Retainage Escrow Agency Fund, the Handicap Scholarship Private Purpose Trust Fund, and the Scottsdale Memorial Hospital Redevelopment Private Purpose Trust Fund. The Hospital Trust Fund manages the investment of monies held in trust for the redevelopment of the Scottsdale Memorial Hospital. As of the end of fiscal year 2003, the net assets of the Scottsdale Memorial

Hospital Trust Fund totaled \$695,000, representing a decrease of \$33,000 in total net assets since June 30, 2002. The change is primarily related to increased expenses directly related to the redevelopment area. Changes to the other Fiduciary Funds were immaterial for the fiscal year.

General Fund Budgetary Highlights

The City's final budget differs from the original budget due to adjustments that were made during the fiscal year. In fiscal year 2003, the slight increase in expenditure budgets was offset by an increase in revenue budgets, thereby maintaining an excess of revenues over expenditures for the year. Net budget increases for expenditures by department totaled \$1.1 million compared to a net budget decrease of expenditures in fiscal year 2002 of \$3.4 million. The net increase is defined as follows:

\$41,000.....	General Government
\$109,000.....	Financial Services
\$821,000.....	Police
\$236,000.....	Community Services
(\$1,000).....	Fire
(\$3,000).....	Citizen & Neighborhood Resources
(\$86,000).....	Economic Vitality

Net budget increases for revenues of \$6.7 million were due to the addition of the following revenue, not previously budgeted for in the General Fund. This revenue was previously reported in the Highway User Revenue Fund:

\$6,700,000	Auto Lieu Tax
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During the year, actual revenues and other resources fell short of budgetary estimates by \$3.6 million compared to a shortage of \$17.8 million in fiscal year 2002. The City was able to adjust revenue estimates for the 2003 budget year due to observed trends from the economic recession which began in fiscal year 2002.

Capital Assets and Debt Administration

Capital Assets

The City's capital assets for its governmental and business-type activities as of June 30, 2003 and 2002, amount to \$2.8 billion and \$2.7 billion, respectively (net of accumulated depreciation). Capital assets include land, buildings and improvements, water and sewer systems, water rights vehicles, machinery and equipment, furniture and fixtures, and construction in progress. The total increase in the City's capital assets (net of accumulated depreciation) for the fiscal years 2003 and 2002 was 2.2 percent as shown in the table below.

Capital Assets, Net of Depreciation

June 30, 2003 (in thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Land	\$ 349,826	\$ 324,138	\$ 13,916	\$ 13,916	\$ 363,742	\$ 338,054
Buildings and Land Improvements	157,514	154,059	9,295	9,746	166,809	163,805
Streets and Storm Drains	1,404,787	1,346,180	-	-	1,404,787	1,346,180
Machinery and Equipment	21,280	23,193	3,656	3,002	24,936	26,195
Water Rights	-	-	64,688	64,489	64,688	64,489
Water System	-	-	343,606	332,675	343,606	332,675
Sewer System	-	-	250,282	212,755	250,282	212,755
Motor Vehicles and Maintenance by Fleet	22,956	23,461	-	-	22,956	23,461
Furniture, Fixtures and Office Equipment	-	-	234	286	234	286
Construction in Progress	67,516	106,694	68,963	104,504	136,479	211,198
Total	\$ 2,023,879	\$ 1,977,725	\$ 754,640	\$ 741,373	\$ 2,778,519	\$ 2,719,098

Major capital asset events during the current fiscal year included the following:

- Completion of construction in progress on the Pima Road Water Transmission Main – Pinnacle Peak Road to Cave Creek Road – A multiple construction contract project accounting for \$23.5 million in budgeted funds.
- The acquisition of an additional 322 acres, totaling \$17.2 million, for inclusion in the McDowell Sonoran Preserve.
- Renovation of the Eldorado Aquatic and Fitness Center. A project that added a new pool facility with a slide, beach entry, therapy pool and lap lanes for a total \$5.4 million.

For government-wide financial statement presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital asset purchases as expenditures. See Section IV in the Notes to the Financial Statements for further information regarding capital assets.

Debt Administration

At the end of the fiscal years 2003 and 2002, the City had total long-term obligations outstanding of \$659.0 million and \$687.5 million, respectively. Of these amounts, \$319.3 million and \$338.0 million, respectively, are general obligation bonds backed by the full faith and credit of the City. The remainder includes revenue bonds, certificates of participation, and other obligations of \$339.7 million and \$349.5 million, respectively.

Outstanding Debt (in thousands of dollars)

	Governmental		Business-Type		Total	
	Activities		Activities			
	2003	2002	2003	2002	2003	2002
General Obligation Bonds	\$ 305,003	\$ 319,657	\$ 14,323	\$ 18,315	\$ 319,326	\$ 337,972
Revenue Bonds	10,990	13,385	71,230	73,945	82,220	87,330
Municipal Property Corporation Bonds	41,955	49,870	10,010	11,555	51,965	61,425
Scottsdale Preserve Authority Bonds	88,270	90,585	-	-	88,270	90,585
Special Assessments Bonds	11,140	13,061	-	-	11,140	13,061
Community Facilities Districts General						
Obligation Bonds	46,355	34,935	-	-	46,355	34,935
Add Deferred Issuance Premiums	6,864	1,572	188	225	7,052	1,797
Less Deferred Amounts on Refunding	(8,327)	(3,585)	(241)	(288)	(8,568)	(3,873)
Total Bonds Payable	502,250	519,480	95,510	103,752	597,760	623,232
Contracts Payable	19,627	21,416	-	-	19,627	21,416
Capital Lease	28,750	28,750	-	-	28,750	28,750
Compensated Absences	11,495	12,455	1,345	1,628	12,840	14,083
Total Long-term Liabilities	\$ 562,122	\$ 582,101	\$ 96,855	\$ 105,380	\$ 658,977	\$ 687,481

During the fiscal year, the City issued \$72,000,000 of General Obligation Refunding Bonds, Series 2002, (advance refunding) dated September 26, 2002, with an average interest rate of 4.5%, to refund \$71,510,000 of Series 1992, 1993, 1994, 1995, 1997, 1998, 1999, 1999A and 2001 General Obligation and Preservation Bonds with an average interest rate of 4.92%. The City will reduce its total debt service payments over the next 22 years by approximately \$3,218,584 and obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$611,585. In addition, the City issued \$30,570,000 of Municipal Property Corporation Refunding Bonds, Series 2002, (forward refunding) dated August 7, 2002, with an average interest rate of 5.5%, to refund \$30,885,000 of Series 1992 Excise Tax Revenue Refunding Bonds with an average interest rate of 6.26%. The City refunded the bonds to reduce its total debt service payments over the next 13 years by approximately \$2,059,698 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$2,073,165.

During fiscal year 2003, the City's total bonded debt decreased by approximately \$25.5 million, in contrast to the increase of approximately \$52.5 million in fiscal year 2002. Although the City completed several refunding transactions, the key contributor to the decrease was normal debt service payments. In addition to the refunding bonds, the City also issued \$12.2 million in General Obligation Bonds for the DC Ranch Community Facilities District, to be used for capital projects.

The State constitution imposes certain debt limitations on the City of six percent (6%) and twenty percent (20%) of the outstanding assessed valuation of the City. The City's available debt margin at June 30, 2003 and 2002 is \$139.9 million and \$114.9 million, respectively, in the 6% capacity and \$467.9 million and \$410.4 million, respectively, in the 20% capacity. Additional information on the debt limitations and capacities may be found in Section IV of the Notes to the financial statements and also in Table XV in the statistical section of this report.

On November 19, 2002, the City Council approved a development agreement with John Lund relating to a new automotive complex at the southeast corner of Scottsdale Rd. and Loop 101 Freeway. The terms of this agreement require the City to reimburse Lund for up to \$5.5 million in public benefits relating to the project including the acquisition of public lands, reimbursement of the City's water and sewer development fees, and reimbursement of the City's stormwater retention payment in lieu. The actual amount will be dependent upon actual costs. However, the reimbursement amount may not exceed \$5.5M even if actual costs are higher. The City has also agreed to pay interest costs on Lund's cost of borrowing on the unpaid balance beginning at 8.5% in the first year and dropping by .5% per year. The reimbursement of the costs listed above is performance-based and will be accomplished by paying Lund quarterly payments equal to 67% of the City's General Fund sales tax receipts received from the new dealership in that quarter, for a maximum of 10 years. The first payment is not due until the calendar quarter after the calendar quarter in which the first certificate of occupancy is issued. Because the total liability is not estimable, earned or due, no debt is recorded on the statement of Net Assets at June 30, 2003 related to this contract.

Subsequent to June 30, 2003 the following events related to debt occurred:

On July 2, 2003 the City Council approved a redevelopment agreement for the former Los Arcos Redevelopment District. Under the terms of the agreement, the City will provide an economic incentive calculated upon sales tax proceeds generated by the project with the Ellman Companies (the developer), up to a net present value maximum of \$36,750,000 plus interest at a rate of 7.18%. This allocation is based on performance-based equal to 69% of the General Fund portion of sales tax generated at the site.

On September 10, 2003, the City sold City of Scottsdale General Obligation Refunding Bonds, Series 2003 in an aggregate principal amount not to exceed \$16,265,000. The sale of these bonds will reduce future debt service payments by \$1.1 million over the next ten years.

Additional information in the City's long-term debt can be found in Section IV of the Notes to the Financial Statements.

City of Scottsdale Bonded Debt Ratings
As of June 30, 2003

	Moody's Investors Service	Standard and Poor's Rating Group	Fitch Investors Service, Inc.
General Obligation (GO)	Aaa	AAA	AAA
Municipal Property Corp (MPC)	Aa1	AA+	AA+
Water and Sewer Revenue (W&S)	Aa1	AA	AA
Highway User Revenue Fund (HURF)	Aa3	AA	Not Rated
Scottsdale Preserve Authority (SPA)	Aa3	AA-	AA-

The City's ratings on uninsured General Obligation Bonds as provided above were affirmed by the Rating Agencies in September 2003 in conjunction with the issuance of General Obligation Refunding Bonds. Rating Agencies also reviewed and confirmed several of the revenue based bond ratings at various times throughout the year.

Economic Factors and Next Year's Budget and Rates

The City is entering an unprecedented third year of declining revenues amid continued economic uncertainty. Despite actual revenues that lagged behind adopted budget estimates, the City recognized the trend early enough to cut expenditures without affecting services.

Fiscal year 2003/04 revenue projections estimate declines or limited growth in many of the City's significant revenue sources, such as privilege tax, transient occupancy tax state-shared revenues, and development permits and fees. Despite these challenges, the City's 2003/04 budget continues to fund essential services, maintains investment in critical capital projects and carries forward Scottsdale's emergency reserve fund. To bring the budget into balance, the City has reduced the size of its workforce through attrition, trimmed employee programs and fringe benefits, reduced the General Fund subsidy to transportation projects, and adopted a more realistic and better-defined Capital Improvement Plan.

All of the above factors were considered in preparing the City's budget for fiscal year 2004. The budget for the 2003/04 year includes:

- Zero-based program budget approach.
- An \$8.8 million dollar decrease in expenditures and transfers-out of the General Fund. Expenditures and transfers-out will decline from an estimated FY 2002/03 year-end level of \$204.3 million to \$195.5 million in FY 2003/04.
- An annualized reduction of \$2.6 million in personnel costs through the elimination of 41 vacant positions. Of the total, 32 positions will come from the General Fund, where revenues are influenced significantly by the economy.
- Externally driven personnel cost increases due primarily to increases in city retirement contributions and health care insurance premiums. Increases in retirement contributions are estimated at \$3.4 million, and increases in health care costs are estimated at \$2.6 million.
- Additional measures to control personnel costs, including the elimination of across-the-board pay increases, elimination or reduction of several fringe benefits and

employee programs and a significant reduction in training and travel expenditures.

- A more realistic and precise plan for continued investment in the city's basic infrastructure and public facilities, combined with a more comprehensive analysis of associated maintenance and operating costs. Improved cash management and other changes in the proposed Capital Improvement Plan will ensure that the City can take advantage of favorable financing and construction markets to build key projects and phase in operating costs for new facilities at a reasonable pace.
- Sustained funding of the General Fund ten-percent reserve to ensure the City can provide basic services in the event of major emergencies. Use of reserves is under close scrutiny by the credit rating industry as governments deal with the tough economy.
- An estimated three-cent drop in the combined property tax rate, from \$1.15 to \$1.12 per \$100 in assessed valuation.
- An average increase of only about \$1.50 in the average homeowner's combined bill for water, sewer, refuse and recycling services.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances for all of those with an interest in the government's finances. If you have questions about this report or need additional financial information, contact:

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Or visit our website at:
<http://www.scottsdaleaz.gov/finance/>

